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SUBJECT: COLOMBIA'S 2008 BUDGET INCREASES SOCIAL AND DEFENSE SPENDING

REF: BOGOTA 6103

¶1. (SBU) SUMMARY: On October 16, Colombia's Congress approved the 2008 national budget with a 9 percent spending increase over the 2007 budget. Despite the increase, the GOC expects to come in below its fiscal deficit target of 3.3 percent of GDP while raising the primary surplus above 1 percent of GDP. GOC officials say they will accomplish this by taking advantage of improved investor confidence to refinance GOC debt and lower servicing costs. The USD 62.7 billion budget includes significant increases in national defense and social spending in line with the Uribe Administration's national development strategy, but continues to focus the majority of national spending on debt service and constitutionally-mandated transfers to local governments. END SUMMARY.

Overview

¶2. (U) The new budget allocates 51 percent to "government operations", entailing personnel costs (10 percent of the total budget), national government operating expenses (3 percent), and transfers to department and municipal governments (38 percent). Remaining fiscal resources are allocated to debt service (31 percent) and public sector investment (18 percent). On the revenue side, approximately 53 percent of the budget will be financed from tax receipts, 37 percent from debt financing and 10 percent from public enterprise profits.

More for Social and Defense Priorities

¶3. (SBU) Finance Ministry Budget and Public Credit Director Julio Torres told EconOff October 29 that the 2008 budget holds closely to President Uribe's national development strategy to reinforce security gains and continue to reduce poverty in Colombia. Torres highlighted the 25 percent increase in defense and security spending as well as the 15 percent rise in social spending. In the social sector, the GOC will increase the number of participants in the "Families in Action" educational and health assistance program to 1.5 million, provide job training to more than 230,000 youth and displaced persons, and increase housing allowances to more than 150,000 people. The GOC will also expand clean water and sewer access to 2 million people. The increases directly reflect the Uribe Administration's priorities to consolidate security improvements, nationalize costs currently covered by

Plan Colombia, and reduce the national poverty rate from 45 percent in 2007 to 35 percent by 2010. With the rise in security spending, defense expenditures will consume 4.9 percent of GDP in 2008. However, the GOC's largest fiscal obligations remain debt service (10.2 percent of GDP) and transfers to local governments (11.3 percent of GDP).

Maintaining Fiscal Discipline

¶4. (SBU) Torres emphasized that the GOC's commitment to fiscal discipline permeated the 2008 budget, with spending cuts in areas such as transport, energy, and commerce. He noted that the Finance Ministry based its revenue projections on a conservative GDP growth rate of 5 percent and a higher-than-expected inflation rate of 5.8 percent. In comparison, local analysts expect 2007 GDP growth to approach 7 percent and estimate 2008 growth will be around 5.3 percent. Inflation has moderated since the beginning of 2007 and most observers expect 2008 inflation to come in under 5.5 percent. Torres also pointed out that Colombia's gross public sector debt continues to fall (from 52 percent of GDP in 2002 to 42 percent in 2007) as well as the portion of debt denominated in foreign currency (from 49 percent in 2002 to 30 percent in 2007). Likewise, the GOC projects the primary surplus (public expenditures not including interest payments) to reach 1 percent of GDP by the end of 2007--the highest in more than 12 years.

How to Pay For It

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¶5. (SBU) Torres expressed confidence the GOC can afford the 9 percent rise in spending without increasing the fiscal deficit as a percentage of GDP. The GOC will achieve this by taking advantage of increased investor confidence from Colombia's improved security situation and the nation's rising credit rating to refinance significant portions of its debt. Through restructuring debt at longer maturities and lower interest rates, the GOC expects to lower its overall debt service costs 1 percent of GDP in 2008. Torres predicted Colombia will come in significantly within the 3.3 percent of GDP fiscal deficit target for 2007 and should do so as well in 2008.

Challenges on the Horizon

¶6. (SBU) Solid economic growth and improved debt financing options certainly provide Colombia additional space for increased public spending and investment. However, Colombia already carries a large debt burden and a change in the current favorable international economic climate could dry up access to lower-cost credit as well as curb domestic growth. Likewise, the GOC expects tax revenues to decrease as much as 12 percent in 2008 due to a new deduction companies will have to reinvest up to 40 percent of profits. Although the tax deduction should foster private investment over the long term, the near term revenue reduction will add pressure to the GOC's fiscal deficit in the next several budget cycles. This could reduce the pool of funds for sustained increases in defense and social spending necessary to lock in Colombia's impressive gains under the Uribe Administration.
Brownfield